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REMARKS:

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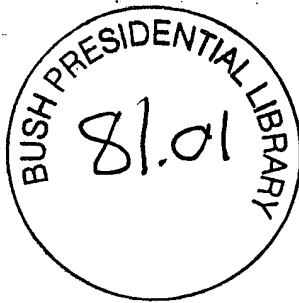
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Central Intelligence Agency



Washington, D.C. 20505

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4 January 1990

MEMORANDUM FOR: Recipients

SUBJECT: *Panama Economic Brief Number 2:
Capital Flight*

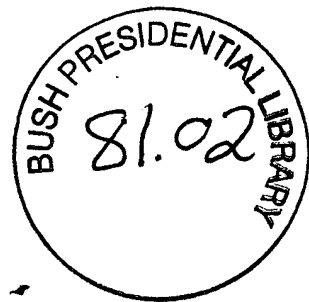
1. The attached is the second of a series of economic briefs focusing on specific issues in Panama as the US and the new government begin the task of economic reconstruction. The first in this series dealt with unemployment and was issued on January 2nd.

2. I hope you find this useful. If you have any questions or comments, or if you have suggestions for other topics,

Attachment

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4 January 1990

MEMORANDUM

SUBJECT: Panama Economic Brief Number 2: Capital Flight

As the Panamanian economy begins to recover from the effects of nearly 30 months of political crisis, one factor in the Endara government's ability to encourage investment and growth will be its success in attracting capital back into the domestic banking system. While there are no reliable estimates of how much capital has fled abroad, a respected Panamanian consulting firm estimates \$1.7 billion in deposits have left Panamanian banks since 1987--almost 40 percent of Panama's pre-crisis internal deposit base. Although much of this capital drawdown was probably shuttled out of the country by the wealthy and businesses, some of the decline was due to normal withdrawals by worried citizens who simply chose to hold cash rather than make deposits to their accounts.

Background

In early 1987, Panamanians--recognizing their banks were beginning to experience severe financial difficulties--attempted to remove their holdings for safekeeping at home or deposit abroad. The "run" which this demand created forced the Noriega regime to introduce restrictions on the amount individuals could withdraw from demand, time, or savings accounts. Restrictions on demand account withdrawals were lifted in January 1989, but the Endara government has announced it will retain controls on other withdrawals until the liquidity of local banks improves and confidence returns to the banking system.

How Much Money Left Panama?

In 1986, before the political crisis began, officials at the National Bank of Panama (BNP) estimated that \$500 million of Panamanian capital resided abroad, mainly in the US. Over the last three years, reporting from embassy and clandestine sources has indicated that the wealthy--and even the middle class--have pulled money out of Panamanian banks for deposit offshore, but there has been no reliable reporting on totals. The regime, for obvious political reasons, apparently made little effort to pursue losses to capital flight beyond imposing restrictions on domestic withdrawals.

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Measuring changes in the quantity of domestic deposits over time provides one means of approximating capital flight.

Panamanian domestic deposits have fallen \$1.7 billion since 1987, a slide of almost 40 percent:

**Banking System Domestic Deposits
(Millions of Dollars)**

	1987	1988	1989 ¹
Domestic Deposits	4397	2967	2718

¹Final Balance as of June 30.

Roughly 70 percent of domestic deposits were in private accounts in 1987, roughly 25 percent were bank holdings, and 6 percent were government deposits.

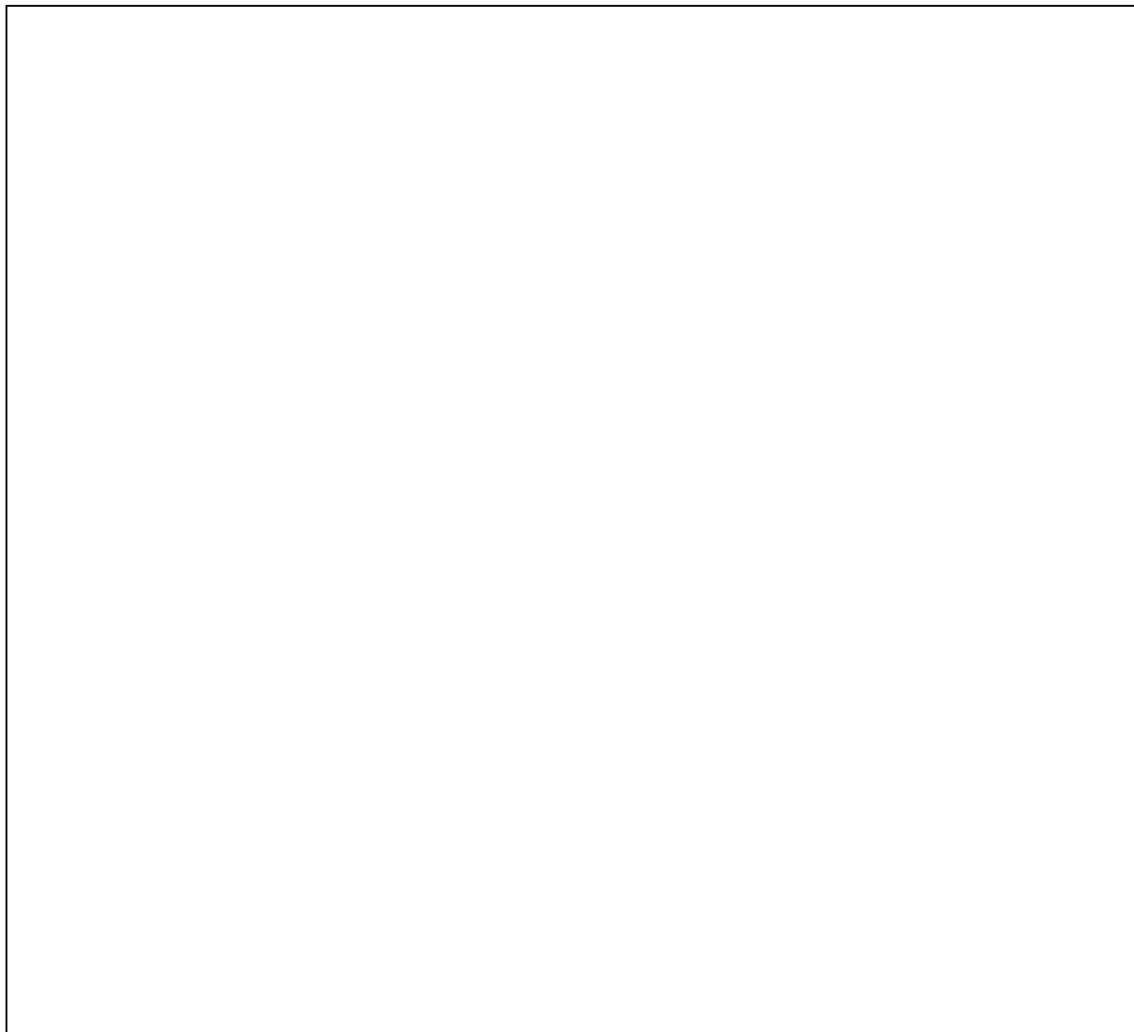
Although much of the shrinkage of deposits may indicate genuine flight of assets from Panama to overseas accounts, some of the drop in deposits has probably been the result of depositors falling back on savings as incomes have declined. Furthermore, deposit statistics may reflect a decision by individuals and businesses to hold a larger than normal proportion of their operating funds in cash to avoid tight government restrictions on withdrawals. Much of this cash is likely to reenter the banking system as customers regain confidence in the banking system and as controls on withdrawals are lifted.

The Challenge for the New Government

Political and economic stability will halt the outward flow of capital from the domestic banking system, and will help stem the flow of deposits from Panama's offshore banking system. In the short term, however, the reduced stock of loanable funds in the domestic banking system as a result of the political crisis has created a credit shortage, and has helped drive interest rates on commercial loans up almost 4 percentage points since 1987 to 14.6 percent. These higher interest rates will make housing, business, and construction loans expensive and could slow the pace of recovery.

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**SUBJECT: Panama Economic Brief Number 2: Capital Flight
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